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January 14, 2008

Honorable Charles R. Breyer
United States District Court for the Northern District of California
450 Golden Gate Ave.
Courtroom 8, 19th Floor
San Francisco, CA 94102

Re: *U.S. v. Gregory Reyes*, Case No. 06-00556-1 CRB

Dear Judge Breyer:

Brocade Communications Systems, Inc. respectfully submits this letter in response to the Court's November 27, 2007 Order re Sentencing Guidelines ("Sentencing Order") and the related briefs filed by the United States and Gregory Reyes on January 10, 2008.¹

In the Sentencing Order, the Court inquired whether it has the authority to impose a fine "directly on Mr. Reyes because the fine is not subject to indemnification since Reyes had reasonable cause to believe his conduct was unlawful." (Sentencing Order at 13-14.) While Brocade takes no position as to whether or in what amount a fine is warranted in Mr. Reyes's case, the possibility that Mr. Reyes might look to Brocade for advancement or indemnification of any criminal fine imposed on him is obviously of great concern to the Company.

In convicting Mr. Reyes, the jury found that Mr. Reyes intentionally defrauded and deceived Brocade and its shareholders. (Jury Instructions, at 24, 28.) Imposing a criminal fine on Mr. Reyes where there is any possibility that he may seek to pass such obligations on to Brocade through a request for indemnification or otherwise would work yet another injustice by potentially foisting responsibility for his conduct on the very persons he was convicted of defrauding. It would also undermine the express purposes of the sentencing statute, namely, to punish the defendant and deter criminal conduct. *See* 18 U.S.C. § 3553 (the Court "shall impose a sentence sufficient . . . to provide just punishment for the offense . . . [and] to afford adequate deterrence to criminal conduct"); *see also* U.S.S.G. § 5E1.2(d) ("the fine should always be

¹ The Court may and should consider this submission by Brocade for purposes of determining Mr. Reyes's criminal fine and restitution. *See* 18 U.S.C. § 3661 ("No limitation shall be placed on the information . . . which a [district court] may receive and consider for the purpose of imposing an appropriate sentence"); *U.S. v. Gamma Tech Indus.*, 265 F.3d 917, 924 (9th Cir. 2001) (allowing third party to present evidence supporting restitution award and holding that the district court "has virtually unfettered discretion in allowing affected individuals to present sentencing information").

Honorable Charles R. Breyer
January 14, 2008
Page Two

sufficient to ensure that the fine, taken together with other sanctions imposed, is punitive.”).

We agree with the Government’s conclusion that the jury’s findings “that the defendant acted ‘willfully’ (defined in part as ‘with the purpose of violating a known legal duty’) and its rejection of his ‘good faith’ defense would preclude indemnification.” (United States Sentencing Memorandum at 15.) Federal law provides that “those *held liable* for violations of certain provisions of the federal securities laws, including the anti-fraud provisions of the 1934 Act, may not recover indemnification.” *Raychem Corp. v. Federal Ins. Co.*, 853 F. Supp. 1170, 1176 (N.D. Cal. 1994). Indeed, “federal law is preemptive and precludes on federal public policy grounds indemnification under state law for judgments incurred for such violations.” David A. Drexler et al., *Delaware Corporation Law and Practice* § 16.02[3][a], at 16-10 (2006) (citing *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1288 (2d Cir. 1969); *Laventhol, Krekstein, Horwath & Horwath v. Horwitch*, 637 F.2d 672, 676 (9th Cir. 1980)).

For example, in *Laventhol*, plaintiffs sued the company as well as its accountants and underwriter for violation of section 11 of the Securities Act, and the underwriter and accountants cross claimed against the company for indemnification. 637 F.2d at 673-74. In affirming the district court’s dismissal of the indemnification claims, the Ninth Circuit held that violations of the federal securities laws are not subject to indemnification as “permitting indemnity would undermine the statutory purpose of assuring diligent performance of duty . . . A securities wrongdoer should not be permitted to escape loss by shifting his entire responsibility to another party.” *Id.* at 676 (citing *Heizer Corp. v. Ross*, 601 F.2d 330, 332 (7th Cir. 1979)).

Similarly, in *Globus*, the district court vacated a jury award of indemnification and held that a person adjudged to have violated the federal securities laws may not seek indemnification:

[It] would be against the public policy embodied in the federal securities legislation to permit [the defendant], which has been found guilty of misconduct in violation of the public interest involving actual knowledge of false and misleading statements or omissions and wanton indifference to its obligations and the rights of others, to enforce its indemnification agreement.

Globus v. Law Research Svc, Inc., 287 F. Supp. 188, 199 (S.D.N.Y. 1968). The Second Circuit affirmed, stating: “to tolerate indemnity under these circumstances would encourage flouting the policy of the common law and the Securities Act. It is well established that one cannot insure himself against his own reckless, willful or criminal misconduct.” *Globus*, 418 F.2d at 1288.

Honorable Charles R. Breyer
January 14, 2008
Page Three

Delaware law is fully in accord with this approach. Under section 145(a) of the Delaware Corporation Law, Delaware General corporations like Brocade may indemnify their officers and directors against criminal fines only if the person to be indemnified (1) acted in good faith; (2) acted in a manner that he reasonably believed to be in or not opposed to the best interests of the corporation; and (3) had no reasonable cause to believe his conduct unlawful. *Id.* Based on the jury's findings, Mr. Reyes cannot satisfy these requirements and, as a result, is not entitled to indemnification in these circumstances. *See In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 64 n.102, 67 (good faith is lacking, and thus indemnification not available, where defendant commits a conscious wrong with a dishonest purpose) (citations omitted); *Equitex, Inc. v. Ungar*, 60 P.3d 746, 750-51 (Colo. App. 2002) (jury findings that defendant committed theft and breach of fiduciary duty attended by fraud "preclude[d] a finding that he acted in good faith" as required for indemnification); *In re Oracle Sec. Litig.*, 829 F. Supp. 1176, 1185 n.6 (N.D. Cal. 1993) ("neither . . . 8 Del. C. § 145, nor Oracle's indemnity policy permit indemnification of an officer or director who has been adjudged to have acted in a manner which he reasonably believed to be opposed to Oracle's interests"); *Charter Comms. v. McCall*, No. 4:05 CV 332, 2005 WL 2076415 (W.D. Mo. Nov. 18, 2005) (defendant who knowingly participated in scheme to defraud shareholders could not argue that he lacked reasonable cause to believe his conduct unlawful, was ineligible for indemnity or advancement of expenses and was required to refund all amounts advanced to date).

In Mr. Reyes' submission, he states that although "he has a contractual right to indemnification for the payment of any fine, [he] will agree to waive his right to indemnification from Brocade for any fines imposed by the Court." (Reyes' Position re Sentencing at 45.) While this concession appears to largely moot the issue, it is unclear precisely what legal effect such a representation may have in any later proceedings.

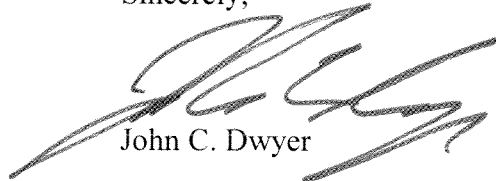
Accordingly, Brocade respectfully requests that, if the Court imposes a criminal fine on Mr. Reyes, its sentencing order expressly prohibit Mr. Reyes from seeking to require Brocade to pay, refund, advance or indemnify any portion of any criminal fine or restitution imposed on Mr. Reyes.²

² Because the Court is statutorily required to impose a sentence that punishes Mr. Reyes, it follows that the Court is authorized to and should prohibit him from attempting to evade payment of such a fine by seeking to require Brocade to pay it. Otherwise, the Court would be powerless to comply with its statutory mandate under 18 U.S.C. § 3553 to impose a just and punitive sentence.

Honorable Charles R. Breyer
January 14, 2008
Page Four

We appreciate the Court's consideration of these matters.

Sincerely,



John C. Dwyer

cc: Richard Marmaro, Esq. (by facsimile)
Timothy P. Crudo, Esq. (by facsimile)
Tyler Wall, Esq. (by facsimile)
